



DEFENSE LOGISTICS AGENCY
THE DEFENSE CONTRACT MANAGEMENT COMMAND
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MAY 23 1997

IN REPLY
REFER TO

AQOC

**MEMORANDUM FOR COMMANDERS, DEFENSE CONTRACT MANAGEMENT
DISTRICTS**

**SUBJECT: DCMC Memorandum No. 97-005, Inclusion of Future Earnings Potential in
Valuations of Stock of Closely Held Corporations Contributed to or Purchased by an
Employee Stock Ownership Trust (ESOT) (INFORMATION)**

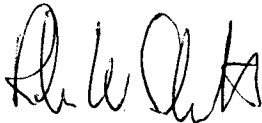
This is an INFORMATION memorandum. Target Audience: All Insurance/Pension Specialists and Administrative Contracting Officers.

As a result of recent discussions with the Department of Defense Inspector General's (DoDIG's) office, the Defense Contract Audit Agency (DCAA) has requested DCMC to coordinate regarding if and when it is appropriate for stock appraisals to include an estimate of a contractor's future earnings and growth potential. DoDIG cited two instances in which DCMC Contractor Insurance/Pension Review (CIPR) reports questioned the portion of the fair market value of the stock that related to goodwill, but DCAA audit reports had not incorporated the questioned costs in DCMC CIPR reports.

The DCAA Headquarters position on this issue is that the governing provisions for determining the fair market value of ESOP stock are contained in Federal Acquisition Regulation (FAR) 31.205-6(j)(8)(E) for pension ESOPs. FAR 31.205-6(j)(8)(E) states, "when the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the valuation guidelines used by IRS." IRS guidelines include "goodwill and other intangibles." Thus, goodwill shall be considered in the Government's determination of fair market value of ESOP stock pension ESOPs.

DCAA Headquarters cites the provisions of Cost Accounting Standard (CAS) 415 for determining the fair market value of ESOP stock for deferred compensation ESOPs. These provisions only require that the stock be priced at fair value. CAS 415 does not contain any guidance on how to determine fair value. However, since FAR recognizes IRS guidelines which include consideration for "goodwill and other intangibles" for valuing stock acquired by an ESOP, DCAA concludes that the provisions of FAR 31.205-49 cannot be used to question goodwill that is included in stock valuations of deferred compensation ESOPs.

DCMC has coordinated on DCAA position on ESOP valuations. Thus, in determinations of fair value of ESOP stock, the value of goodwill should be considered. DCMC Headquarters point of contact for this issue is Tricia Kobus, Contract Payment and Business Practices Team, (703) 767-3401, DSN 427-3401, or Internet tricia_kobus@hq.dla.mil.


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